SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 239, and 270

[Release Nos. 33–7243; IC–21538; File No. S7–32–95]

RIN 3235–AG63

Calculation of Yield by Certain Unit Investment Trusts

AGENCY: Securities and Exchange Commission.

ACTION: Proposed amendments to rules and forms.

SUMMARY: The Commission is proposing for public comment rule and form amendments that would require certain unit investment trusts (''UITs'' or ''trusts'') to use a uniform formula to calculate yields quoted in their prospectuses, advertisements, and sales literature. Use of the uniform formula by UITs is designed to permit investors to assess more accurately the anticipated yield from a UIT and to make comparisons of yields among UITs.

DATES: Comments on the proposed amendments should be received on or before January 29, 1996.

ADDRESSES: Three copies of all comments should be submitted to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549. All comment letters should refer to File No. S7–32–95. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street NW., Washington D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Anthony R. Bosch, Senior Attorney, or Joseph E. Price, Deputy Chief, (202) 942–0721, Office of Disclosure and Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (''Commission'') today is proposing for comment:

(1) Amendments to Form S–6 [17 CFR 239.16] under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] (the ''1933 Act''), the form used by UITs to register securities under the 1933 Act, that would standardize the computation of yield by certain UITs in their prospectuses;

(2) Amendments to rule 482 [17 CFR 230.482] under the 1933 Act, together with the amendments to Form S–6, that would require certain UITs including quotations of return in their advertisements also to include a quotation of yield calculated in accordance with the formula in Form S–6; and

(3) Amendments to rule 34b–1 [17 CFR 270.34b–1] under the Investment Company Act of 1940 [15 U.S.C. 80a–1 *et seq.*] (''1940 Act'') that would require certain UITs including quotations of return in their sales literature also to include a quotation of yield calculated in accordance with the formula in Form S–6.

Executive Summary

The Commission is proposing to adopt a uniform formula, called the ''Estimated Yield Formula,'' for the calculation of the anticipated yield of UITs that invest substantially all of their assets in fixed income securities (''Fixed Income UITs''). Under the proposed rule and form amendments, a Fixed Income UIT would be required to include in its prospectus a yield quotation calculated pursuant to the Estimated Yield Formula (''Estimated Yield''). A Fixed Income UIT that includes a quotation of yield, or other similar quotation purporting to demonstrate the income to be earned or distributions to be made by the UIT, in its advertisements and sales literature would be required to include and give equal prominence to its Estimated Yield. The proposed amendments are intended to establish a uniform standard for calculating UIT yield to enhance the ability of prospective investors to make informed investment decisions.

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I. Background

A UIT is a type of investment company that issues securities, typically called ''units,'' representing undivided interests in a relatively fixed portfolio of securities.[1] UITs are typically sponsored by broker-dealers, which assemble the UIT's portfolio securities, deposit the securities in a trust, and sell units of the UIT in a public offering. Unlike a mutual fund, a UIT does not have a board of directors or an investment adviser and its portfolio is not actively managed.

UIT units are redeemable securities that entitle an investor to receive his or her proportionate share of the UIT's net assets upon redemption. Notwithstanding this characteristic of UIT units, most UIT sponsors voluntarily maintain a secondary market for units of the UITs they sponsor.[2] This secondary market reduces the frequency with which trusts are forced to liquidate as a result of unitholder redemptions.

UITs currently have approximately $74 billion in aggregate assets, most of which (88 percent) are held by Fixed Income UITs.[3] In marketing Fixed Income UITs to investors, sponsors and broker-dealers typically quote a rate of return that estimates the income that an investor who holds a unit for the expected life of the UIT can anticipate receiving. This method of marketing Fixed Income UITs is similar to the manner in which individual bonds are marketed to investors based on a bond's ''yield to maturity,''[4] and may be contrasted to mutual fund performance marketing, which is based exclusively on the past performance of the mutual fund.[5] The prominence of the

[1] Section 4(2) of the 1940 Act [15 U.S.C. 80a–4(2)] defines a UIT as an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities. *See generally* Harman, *Emerging Alternatives to Mutual Funds: Unit Investment Trusts and Other Fixed Portfolio Investment Vehicles*, 1987 Duke L.J. 1045 (1987).

[2] Sponsors that maintain secondary markets in the shares of the UITs they sponsor are considered issuers under section 2(4) of the 1933 Act [15 U.S.C. 77b(4)] and must comply with the registration requirements of the 1933 Act for units they offer to the public. In addition, under section 24(d) of the 1940 Act [15 U.S.C. 80a–24(d)], a broker-dealer selling UIT shares in the secondary market must comply with section 5(b) of the 1933 Act [15 U.S.C. 77e(b)] if the sponsor is continuing to sell shares in the trust.

[3] Source: Investment Company Institute. Tax-free debt securities represent approximately $57 billion (89 percent) of the securities held by Fixed Income UITs. *Id.*

[4] Yield to maturity is the discount rate that equates the present value of future promised cash flows from the security to the current market price of the security. *See* W. Sharpe, *Investments*, 1028 (5th ed. 1995).

[5] *See* Item 22(b) of Form N–1A under the 1940 Act [17 CFR 274.11A], which specifies the manner in which mutual funds calculate yield and total

anticipated income rate to the investment decisions of UIT investors makes it particularly important that the rate is uniformly and accurately calculated.

Before 1989, estimated current return (''ECR'') was the performance measurement used by Fixed Income UITs. The ECR of a trust is calculated by dividing the trust's annual interest income per unit (net of expenses) by the offering price per unit.[6] While a trust's ECR is a reasonably accurate measure of anticipated cash flows from a unit, it does not take into account the full effect of bonds in a trust's portfolio that are trading at a market discount or premium in the same manner as the yield to maturity of a bond. As a result, the ECR of a Fixed Income UIT comprised of premium bonds may overstate the return that may be reasonably anticipated over the life of the trust.[7]

ECR was developed at a time when interest rates were fairly stable and UIT sponsors bought and deposited bonds at par. In the 1970s, interest rates became more volatile,[8] and in the 1980s the practices of some UIT sponsors began to change. In 1989, the Commission's staff became aware that some UITs proposed to invest a significant portion of their assets in premium bonds.[9] In response to concerns expressed by the staff that the quotation of ECR by such trusts could mislead prospective investors, the UIT industry developed a formula, the estimated long-term return (''ELTR'') formula,[10] as a solution to ECR's limitations.[11] ELTR is calculated by averaging the yields to maturity of the bonds held by a UIT, giving weight to the period remaining to maturity of each bond and the percentage of the UIT's portfolio that consists of each bond. Because yield to maturity reflects any premium or discount at which a bond may be trading, ELTR addressed the primary limitation of the ECR formula and the concerns of the staff.

Since 1989, the UIT industry and the Commission's staff have held discussions to develop a permanent UIT yield formula. In March of this year, the Investment Company Institute (''ICI'') submitted to the Commission a rulemaking proposal to standardize the calculation of UIT yield based on a revised ELTR formula.[12] The revisions primarily were intended to address deficiencies in the application of the ELTR formula to trusts with short-term termination dates (or trusts that are likely to terminate in the near future due to bonds in the trust's portfolio being called). The Division of Investment Management, in a letter to the ICI, stated that it would not object to the use of the ELTR formula, revised in accordance with the ICI's proposal, until the Commission adopts rule and form amendments concerning a uniform yield formula for UITs.[13]

II. Discussion

The Commission is now proposing to adopt rule and form amendments to codify a uniform method for the calculation of yield by UITs. The proposed Estimated Yield Formula is based largely on the ELTR formula but, as suggested by the ICI's most recent submission and described in more detail below, would include an adjustment that would require a trust that charges a sales load to reflect the amortization of the load based on the weighted-average expected life of the trust's portfolio securities. The proposed Estimated Yield Formula would be used to determine the yield of newly offered trusts, as well as for trusts the units of which trade in a secondary market.

A. Proposed Estimated Yield Formula

Under the proposed Estimated Yield Formula, a Fixed Income UIT would calculate its Estimated Yield by first calculating the average yield to maturity, weighted by market value and time to maturity, of its portfolio securities, reducing this yield by trust expenses (expressed as a percentage), and multiplying the remainder by a percentage representing the net amount of the trust's offering price that is invested.[14] The proposed Estimated Yield Formula would then require a Fixed Income UIT to reduce the resulting ratio by a ''sales charge factor'' to reflect the ''cost'' to a UIT investor of not receiving upon termination of the trust (or upon sale or redemption of the units or partial liquidation of the trust) the portion of the amount initially invested that represents sales load. Thus, the proposed Estimated Yield Formula would not only reflect premiums or discounts on portfolio securities, but also the ''premium'' an investor who is charged a sales load pays for the units.

1. Sales Load

a. Front-End Sales Loads. Most investors in an initial offering of a UIT pay at the time of purchase a sales load (''front-end'' sales load) calculated as a

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return. Investment Company Act Rel. No. 16245 (Feb. 2, 1988) [53 FR 3868 (Feb. 10, 1988)] (adopting amendments to rule 482 and other rules to standardize the calculation of mutual fund performance).

[6] ECR is analogous to ''current yield,'' a method of quoting yield on an individual bond based on the amount of annual income an investor will earn if the bond is purchased today, as a percentage of today's price. *See* W. Sharpe *supra* note 4 at 1006.

[7] For example, a Fixed Income UIT consisting of bonds that, at the time of deposit, were trading at 10% premium to their par value, paying a 5% interest coupon every six months, and maturing in ten years, would have an ECR of 9.09% (assuming no sales load or expenses). If, however, a unitholder holds the units until maturity, the unitholder's return would be 8.5%. The lower rate reflects that the 10% premium would not be recovered by the unitholder when the UIT matures.

[8] From 1970 to 1980 interest rates on six-month treasury securities ranged from 5.25% in 1976 to 11.43% in 1980. *See Statistical Abstracts of the United States,* U.S. Department of Commerce, 522–23 (1981) (based on annual averages of monthly data for interest rates between 1970 and 1980). In the 1980s, interest rates on six-month treasury securities ranged from 13.81% in 1981 to 6.02% in 1986. *See Statistical Abstracts of the United States,* U.S. Department of Commerce, 525 (1994) (based on annual averages of monthly data for interest rates between 1980 and 1990).

[9] The staff became aware of these UITs during its routine review of pre-effective offerings. Several articles in the financial press also raised questions whether ECR was an appropriate measure of yield for a UIT that held significant investments in premium bonds. *See e.g.,* Weberman, *Doesn't Honesty Sell?* Forbes, Oct. 16, 1989, at 297.

[10] In 1989, an *ad hoc* committee of UIT sponsors, formed to study the calculation of UIT yield, submitted to the Commission a proposed uniform UIT yield formula. Letter from James J. Wesolowski, Vice President and General Counsel, John Nuveen & Co. Inc., to Robert E. Plaze, Special Counsel, Division of Investment Management (Apr. 11, 1989). Subsequently, the Investment Company Institute submitted a revised UIT yield formula. Letter from David Silver, President, Investment Company Institute, to Kathryn B. McGrath, Director, Division of Investment Management (Dec. 7, 1989). A copy of each letter is contained in File No. S7–32–95.

[11] At the time, the Commission's Division of Investment Management adopted a policy of not exercising its delegated authority to accelerate the effectiveness of any UIT registration statement the prospectus of which disclosed the UIT's ECR unless the prospectus also contained the UIT's ELTR. *See* letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management (Jan. 11, 1990). Subsequent to the Division's 1990 letter, the Directors of the Divisions of Market Regulation and Investment Management sent a letter to UIT sponsors and broker-dealers that are active in the UIT secondary market stating that quotations of a UIT's ECR should be accompanied by a quotation of the UIT's ELTR, if the ECR varies materially from the estimated long-term return of the trust. Letter from Marianne K. Smythe, Director, Division of Investment Management, and William H. Heyman, Director, Division of Market Regulation (Apr. 8, 1992). A copy of each letter is contained in File No. S7–32–95.

[12] *See* letter from Craig S. Tyle, Vice President and Senior Counsel, Investment Company Institute, to Robert E. Plaze, Assistant Director, Division of Investment Management (Mar. 24, 1995). A copy of this letter is contained in File No. S7–32–95.

[13] Investment Company Institute, (pub. avail. Aug. 2, 1995).

[14] This last step reflects that a portion of the offering price will be deducted in the form of a sales load and thus, will not be invested and earn income for the unitholder. As discussed *infra* section II.A.1. of this Release, this step does not, however, reflect the effect on investor return that the amount of the sales load will not be returned to the investor at the termination or redemption of the trust.

percentage of the public offering price.[15] Although the ELTR formula currently being used reflects that a portion of the offering price representing sales load will not be invested (and thus will not earn interest for the unitholder), it does not amortize sales load to reflect the effect on investor return of not receiving the sales load at the termination of the trust or redemption of the units. This limitation has the greatest effect for yield calculations involving short-term trusts and trusts that are likely to terminate in the near term due to bonds in the portfolio being called.[16] In attempting to deal with this limitation, the proposed Estimated Yield Formula would require Fixed Income UITs to amortize sales load to reflect more accurately the effect of sales load on investor return.

Under the proposed formula, a Fixed Income UIT would amortize sales load over a time period (''amortization period'') determined by averaging the ''expected lives'' of the bonds in the trust weighted by market value.[17] The expected life of most bonds in the portfolio would be determined by each bond's maturity date.[18] To account for the possibility of an early redemption of the bonds, however, the proposed Estimated Yield Formula would require trusts to calculate the expected life of a bond with call features by comparing the bond's yield to maturity to the bond's yield to ''worst'' call (the call feature to which the bond is priced that would result in the bond's lowest yield).[19] A bond's worst call date would be used if the bond's yield to maturity exceeds its yield to worst call by more than 40 basis points.[20]

The Commission considered requiring, as an alternative method of determining the amortization period, the use of the weighted average of each bond's worst call date as the expected life of the trust. In its submission, the ICI explained that this alternative may underestimate the life of a bond (and thus, the expected life of the trust), particularly when transaction costs would make many refundings economically infeasible.[21] Because the likelihood of a bond being called depends in large part on whether the refunding will provide sufficient savings to the issuer, the ICI stated that the ''spread'' between a bond's yield to maturity and its yield to call would provide an appropriate measure for determining a bond's expected life—the greater the savings for the issuer, the more likely the bond will be called.

The Commission also considered an alternative that would require the amortization period to be determined by the expected life of the trust. The Commission is not proposing this method because such a method would permit a trust sponsor to lengthen the amortization period by including one long-term bond in a trust consisting of bonds that have much shorter maturities.[22] Moreover, such a method would appear not to reflect accurately the effect on investor return of an early partial or complete liquidation of the trust and, thus, would result in an amortization period that is too long. In the same way sales load affects yield on an investment in a short-term trust more than an investment in a long-term trust, a unitholder's yield from an investment in a long-term trust will be affected if a portion of the investment is returned before maturity. To account for these effects, under the proposed formula, sales load would be amortized over the time each dollar of a unitholder's investment can be expected to remain invested, assuming the unitholder does not sell or redeem trust units before termination of the trust.

The proposed Estimated Yield Formula would amortize the sales load over the amortization period using a method designed to reduce annual yield by an amount equal to a stream of future annual payments that equate to the amount of the front-end sales load. Comment is requested on the proposed Estimated Yield Formula's method of amortization of sale load and, specifically, on alternative methods that might reflect more accurately the effect of sales load on investor return. Comment is requested on an alternative method that would require sales load to be amortized by treating the load as an additional premium in a bond's yield to maturity calculation. This alternative would require a trust to calculate each bond's yield to maturity by adding to the price of the security an amount equal to the security's pro rata portion of the sales load weighted by the security's market value.[23] In addition, comment is requested on a straight-line amortization method (*i.e.*, dividing the sales load by the amortization period) and whether this alternative would provide a simpler method for amortizing sales load.

b. Deferred Sales Loads. The Commission has issued several exemptive orders permitting UITs to impose sales charges on units on a deferred basis.[24] Under the terms of the exemptions, a UIT sponsor determines the maximum sales charge per unit at the time portfolio securities are deposited in a trust, and the sales charge is paid by the unitholder in installments over a period following the purchase of the units.[25] The proposed Estimated Yield Formula would require Fixed Income UITs to use the maximum sales load, determined by the sponsor at the time of deposit, for calculating Estimated Yield of trusts whose unitholders pay a deferred or installment load.[26]

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[15] Some UITs, pursuant to a Commission exemptive order, have implemented deferred or installment loads. *See* discussion *infra* section II.A.1.b.

[16] For example, assuming the trust in *supra* note 7 charged a 4.8% sales load and matured in five years, the ELTR of the trust would be 8.09%, although the investor's actual return would be 6.34%.

[17] Instruction 8 to the proposed Estimated Yield Formula. For purposes of simplification, proposed amendments to rule 482, (requiring disclosure in trust advertisements and sales literature), would refer to the expected life of each bond in the trust as the ''expected life of the trust.'' Proposed rule 482(f) under the 1933 Act [17 CFR 230.482(f)].

[18] The maturity date is the date upon which the principal of a debt security becomes due and payable to the securityholder. *See Glossary of Municipal Securities Terms,* Municipal Securities Rulemaking Board, (Adapted from the State of Florida's Glossary of Municipal Bond Terms) (1985).

[19] Rules adopted by the Municipal Securities Rulemaking Board (''MSRB'') require that, when confirming customer orders, yield be calculated to the lowest yield to call, yield to par option, or yield to maturity (''yield to worst''). This assures that an investor will realize, at a minimum, the stated yield, even in the event that a call provision is exercised. MSRB Rule G–15(a)(i)(I), MSRB Manual (CCH) ¶3571.

[20] Maturity date would be used to determine the expected life of any bond priced at par or at a discount and for any bond priced at a premium if the bond's yield to maturity does not exceed the bond's yield to worst call by more than 40 basis points (.4%).

[21] *See* letter from Craig S. Tyle, Vice President and Senior Counsel, Investment Company Institute, *supra* note 12.

[22] *Id.*

[23] Under this alternative, the portfolio's weighted average yield to maturity would not be reduced by multiplying the yield by a percentage representing the net amount of the trust's offering price that is invested.

[24] *See* Merrill Lynch, Pierce, Fenner & Smith, Inc., Investment Company Act Rel. Nos. 13801 (Feb. 29, 1984) [49 FR 8512 (Mar. 7, 1984)]; 13848 (Mar. 27, 1984) [30 SEC Docket 192]; 15120 (May 29, 1986) [51 FR 20389 (June 4, 1986)]; and 15167 (June 24, 1986) [35 SEC Docket 1735]. PaineWebber, Inc., Investment Company Act Rel. Nos. 20755 (Dec. 6, 1994) [59 FR 64003 (Dec. 12, 1994)]; and 20819 (Jan. 4, 1995) [58 SEC Docket 1586].

[25] *Id.* The installments are paid from the distributions of the trust until the maximum sales charge is collected. If distribution income is insufficient to pay a deferred sales charge installment, the trustee, under the terms of the trust indenture, will sell portfolio securities in an amount necessary to provide the requisite payments. If a unitholder redeems or sells to the sponsor his or her units before the total sales charge has been collected from installment payments, the balance of the sales charge may be collected at the time of the redemption or sale.

[26] Instruction 7 to the proposed Estimated Yield Formula.

2. Compounding

The proposed Estimated Yield Formula would omit a step proposed by the ICI in which a trust's average yield to maturity is divided by twelve and re-annualized using a method that, in effect, would compound a monthly yield. The Commission is concerned that such a calculation could materially overstate the anticipated yield of a trust and is not proposing to provide for compounding of a trust's average yield to maturity.

In its request for rulemaking and in other correspondence with the staff, the ICI has argued that Fixed Income UITs primarily compete with mutual funds.[27] Mutual funds calculate yield according to a Commission formula that effectively compounds earnings.[28] The ICI believes that Fixed Income UITs also should be permitted to compound earnings or they would be placed at a competitive disadvantage to mutual funds.[29]

The compounding element of the mutual fund yield formula reflects the internal compounding of dividends within mutual funds as a result of their reinvestment of interest from bonds (and other securities) upon receipt. Because of the fixed nature of UITs, interest payments received are not reinvested, but are held by the trust's custodian until they are distributed to unitholders, and thus no compounding occurs within the UIT.[30] The ICI has suggested, however, that because dividends distributed to unitholders may be reinvested in a mutual fund made available by a UIT sponsor, unitholders may obtain the benefits of compounding. A similar argument may be made for compounding the calculation of yield to maturity of a bond. In both the cases, however, such a yield would not constitute a yield from an investment, but from an investment plan. Moreover, the ICI's proposed formula would assume reinvestment of interest payments immediately upon receipt by the trust and would not reflect the delay from the time a trust receives the coupon payments until it distributes those payments to unitholders, when only then could they reinvest the distributions.[31]

In developing this proposal and reviewing the ICI proposal, the Commission has been primarily concerned with the accuracy of the formula. Compounding yield to maturity of a trust's portfolio securities would result in a trust advertising an Estimated Yield of the UIT that is *higher* than the yield an investor would have obtained if the investor purchased each security outside of the UIT. For example, if a bond trading at par with a yield to maturity of 8 percent is deposited into a UIT (assuming no trust expenses or sales load), the ICI-proposed formula would produce a yield of 8.13 percent.[32] To avoid such a result, the Commission is not proposing that the Estimated Yield Formula provide for compounding.

Comment is requested whether the Estimated Yield Formula should contain an element of compounding. Commenters supporting compounding should address the variance that would be created between the yields to maturity of the bonds in which UITs invest and Estimated Yield that would be calculated under such a formula.

3. Accrued Interest

The public offering price of units of a Fixed Income UIT includes not only the price of the securities in a portfolio plus a sales charge, but also a proportionate share of accrued interest of each security in the trust.[33] The amount an investor pays for the purchase of a bond, also includes accrued interest. The calculation of a bond's yield to maturity excludes consideration of the accrued interest because it will be returned to bondholders upon receipt of the next interest payment. Thus, the amount of accrued interest paid by a purchaser of a bond does not represent part of the bondholder's investment. In contrast, all of the accrued interest paid by a unitholder of a UIT will not be returned in the trust's first distribution; some or all will remain part of the net asset value of the trust and will be used to eliminate fluctuations in periodic distributions and to compensate the trustee who has use of the cash.

Unitholders generally receive equal distributions, on a monthly, quarterly, semi-annual, or annual basis, based on the interest income of the bonds in the portfolio less expenses. Because interest on the bonds is not received at a constant rate throughout the year, a trust may not have cash from interest payments available to meet distributions to unitholders at the end of a period. In such a case, the trustee will draw on the accrued interest account, which will be replenished during a period in which interest is received in excess of what is needed to make distributions to unitholders. A trust's retained accrued interest balance generally remains positive after the trust's first distribution.[34] Each unit's proportionate share of retained accrued interest, if any, is part of the trust's net asset value. As such, it is returned to unitholders upon redemption, sale of a unit, or liquidation of the trust.[35]

The proposed Estimated Yield Formula would reflect the delay in repayment of accrued interest by treating accrued interest as of the date of deposit as a trust asset.[36] The formula would achieve this result by requiring Fixed Income UITs, in calculating the yield to maturity of each bond in the trust's portfolio, to subtract from the amount of the bond's first coupon payment and to add to the amount of the bond's last coupon payment the amount of the bond's accrued interest as of the date of deposit of the bond in the trust.[37] The Commission requests comment on the proposed treatment of accrued interest under the Estimated Yield Formula.

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[27] *See* letter from Craig S. Tyle, Vice President and Senior Counsel, Investment Company Institute, *supra* note 12; letter from David Silver, President, Investment Company Institute, *supra* note 10; letter from Craig S. Tyle, Associate General Counsel, Investment Company Institute, to Gene Gohlke, Acting Director, Division of Investment Management (June 29, 1990). A copy of each letter is contained in File No. S7–32–95.

[28] Item 22(b) of Form N–1A under the 1940 Act [17 CFR 274.11A].

[29] In an earlier submission, however, the UIT industry asserted that the formula should replicate the yield of a bond. *See* letter from James J. Wesolowski, Vice President and General Counsel, John Nuveen & Co. Inc., *supra* note 10. This submission included a proposed formula, the ELTR formula UITs currently use to calculate yield, that does not compound yield to maturity.

[30] To the extent that the use of the dividends and other income by the trust custodian before their distribution reduces the custodian's fees and thus UIT expenses, their use already would be reflected in the proposed Estimated Yield Formula as a higher resulting Estimated Yield.

[31] *See* letters from the Investment Company Institute cited in *supra* note 27.

[32] Higher yields would produce greater differences between the yields.

[33] Accrued interest on the purchase of a bond is the dollar amount of interest, based on the coupon rate of interest, which has accumulated on a security from the most recent interest payment date up to but not including the date of settlement of the purchase. Accrued interest is paid to the seller by the purchaser of a bond.

[34] *See* letter from David Silver, President, Investment Company Institute, *supra* note 10.

[35] In addition, as securities in the portfolio mature, or are called or sold, the accrued interest applicable to such bonds is distributed to unitholders.

[36] In its 1989 submission, the ICI proposed to treat accrued interest as a non-earning asset, although the method used would have been different from that of the proposed Estimated Yield Formula, reflecting differences in the two formulas. *See* letter from David Silver, President, Investment Company Institute, *supra* note 10. The ICI's 1995 submission, upon which the Estimated Yield Formula is based, does not appear to provide for similar treatment.

[37] Instruction 2 to the proposed Estimated Yield Formula. This Instruction would not apply to trusts in which all accrued interest at the date of deposit is paid by the sponsor or a person other than a unitholder.

4. Principal Cash Balances

Units purchased in the secondary market often have, as a component of their net asset value, cash balances that represent proceeds from bonds that have matured, or have been redeemed, called, or sold. This cash is held by the trust in the form of principal account cash balances to be distributed to unitholders as part of the next distribution. These amounts are returned to unitholders shortly after their receipt by the trust and do not represent part of the unitholders' investment. Thus, the proposed Estimated Yield Formula would exclude these amounts from the calculation of the trust's net asset value.[38]

5. Market Discount on Tax Exempt Securities

The proposed Estimated Yield Formula would require Fixed Income UITs, in determining the yield to maturity of tax exempt securities held by the trust, to exclude any market discount that would be treated as capital gain under federal income tax.[39] In its 1989 submission, the ICI proposed an alternative that would permit Fixed Income UITs to quote an Estimated Yield that reflects the accretion of market discount and to disclose the portion of that yield that could be subject to federal income tax.[40] The Commission is not proposing to include the ICI's proposed alternative in the determination of Estimated Yield out of concern that the ICI's approach would lead to a confusing multiplicity of Estimated Yield quotations, particularly for prospective investors in trusts quoting more than one yield because of different distribution options.[41] The Commission requests comment on the Estimated Yield Formula's proposed treatment of market discount on tax exempt securities.

6. Preferred Stock, Asset-Backed Securities, and Adjustable-Rate Securities

As discussed above, the proposed Estimated Yield Formula is designed to measure the anticipated yield from a portfolio of *fixed* income securities that yield income at a predictable rate. Most UITs that invest their assets in corporate, municipal, or U.S. government bonds invest almost exclusively in these securities. These securities are issued with stated maturities and fixed interest rates, and thus, the yield of trusts that invest in these securities can be estimated with reasonable certainty. A Fixed Income UIT, however, may have some of its assets invested in preferred stock, asset-backed securities,[42] or adjustable-rate securities,[43] the issuers of which have no legal obligation to pay a fixed amount of interest or dividends. Because the income from these securities is not as predictable as the income from traditional bonds, the Commission is proposing to require trusts holding these instruments to disclose in their prospectuses, advertisements, and sales literature that some of their assets are invested in these types of securities and that, as a result, their yields likely will fluctuate.[44]

Approximately three percent of the assets of UITs are invested in trusts substantially all the assets of which consist of preferred stock, asset-backed securities, or adjustable-rate securities.[45] The Commission is proposing that these UITs use the proposed formula to calculate yield, but would require them to characterize the yield as ''Current Yield'' to emphasize that it does not represent a rate an investor can expect to receive in the future. In addition, these trusts would be required to provide a statement that, because the continued payment of interest (and return of principal for asset-backed securities) for these types of securities cannot be predicted, the trust's yield *will* vary and, as a result, actual investor experience *will* be different from the quoted yield.[46]

The Commission requests comment on the proposed treatment of preferred stock, asset-backed securities, and adjustable-rate securities. Specifically, the Commission requests comment whether the proposed disclosure adequately would inform investors of the uncertainty of yield estimates for trusts that invest in these types of securities. The Commission also requests comment whether the proposed formula should define those trusts that invest ''substantially'' all their assets in preferred stock, asset-backed securities, and adjustable-rate securities and, if so, what that definition should be.

7. Units of Other Trusts

Fixed Income UITs sometimes hold units of other trusts in their portfolios. Although the Estimated Yield of these trusts could be used as their yield to maturity in the Estimated Yield Formula, in its 1989 submission the ICI urged that the Commission not adopt such a requirement because it would be complicated and burdensome. According to the ICI, in many cases these trusts are no longer offered in the secondary market and thus the trust sponsor no longer calculates their yield.[47] Instead, the ICI suggested that the Commission permit UITs to calculate the yield to maturity of these units based on the average dollar price, average coupon rate, and average yield to maturity of the securities held by the trust.[48] The Commission is proposing the approach recommended by the ICI, but only for units of trusts that are not currently calculating Estimated Yield.[49]

8. Tax Equivalent Yield

The proposed Estimated Yield Formula would provide Fixed Income UITs a method of calculating a tax equivalent yield.[50] A tax equivalent yield would demonstrate the taxable yield necessary to produce an after-tax yield equivalent to that of a trust which invests in tax exempt securities. Under the proposal, tax equivalent yield would be calculated by dividing that portion of the yield of the trust that is tax exempt by one minus a stated income tax rate and adding to the product that portion, if any, of the yield of the trust that is not tax exempt.[51] This would provide a

[38] In its 1989 submission, the ICI suggested a similar treatment of principal account cash balances. *See* letter from David Silver, President, Investment Company Institute, *supra* note 10.

[39] Instruction 5 to the proposed Estimated Yield Formula. This approach is similar to the treatment of market discount on tax exempt securities by the mutual fund yield formula. *See* Instruction 1(e) to Item 22(v)(ii) to Form N–1A under the 1940 Act [17 CFR 274.11A].

[40] *See* letter from David Silver, President, Investment Company Institute, *supra* note 10.

[41] *See* discussion *supra* section II.A.3.

[42] The cash flows of asset-backed securities, including mortgaged-backed securities, are based on an underlying pool of mortgages or other income-producing assets. *See* F. Fabozzi, *The Handbook of Fixed Income Securities,* 16–19 (4th ed. 1995).

[43] Adjustable-rate securities, including floating-rate and variable-rate securities, have interest rates that adjust periodically over their stated life. *Id.* at 7.

[44] Instruction 15 to the proposed Estimated Yield Formula. The proposed Estimated Yield Formula also would provide specific instructions for calculating yield to maturity for these securities and for determining their expected life for purposes of amortizing sales load. Instructions 12–14 to the proposed Estimated Yield Formula.

[45] Source: Investment Company Institute.

[46] Instruction 16 to the proposed Estimated Yield Formula.

[47] *See* letter from David Silver, President, Investment Company Institute, *supra* note 10.

[48] *Id.*

[49] Instruction 6 to the proposed Estimated Yield Formula.

[50] UITs would not be required to quote a tax equivalent yield.

[51] Instruction 10 to the proposed Estimated Yield Formula. The proposed method of calculating tax equivalent yield is similar to the mutual fund yield formula's method of calculating tax equivalent

uniform method for calculating tax equivalent yield.[52] The Commission requests comment on the proposed method of calculating tax equivalent yield for Fixed Income UITs. In addition, the Commission requests comment whether bonds that distribute interest income that may be subject to the alternative minimum tax under Federal tax law should be considered taxable bonds for purposes of the proposed Estimated Yield Formula. The Commission requests comment whether, if these bonds are not considered taxable bonds, additional disclosure should be required by trusts holding themselves out as distributing tax exempt income but which invest in bonds that distribute interest income that, when distributed to unitholders, may be subject to the alternative minimum tax.

B. Scope of Application of the Proposed Estimated Yield Formula

1. Prospectuses

The Commission is proposing to amend Form S–6 to require Fixed Income UITs to include in the summary financial data, typically provided in the front part of each UIT prospectus, a quotation of its Estimated Yield. The proposed Estimated Yield Formula would define ''Fixed Income UITs'' as trusts investing substantially all their assets in bonds and other debt instruments, preferred stock, or a combination of these types of securities. Comment is requested on the proposed definition of Fixed Income UITs. Comment is specifically requested whether the Estimated Yield Formula should define the term ''substantially,'' and, if so, what that definition should be.

The amendments would not preclude a trust from including a quotation of the UIT's ECR provided that, under the circumstances, the ECR is not misleading and that the differences between ECR and Estimated Yield are clearly described in the prospectus. As proposed, the amendments would require a trust using ECR or some other method of estimating return (*e.g.*, ELTR) to include a brief description of the differences between Estimated Yield and the other method and a statement that the trust's Estimated Yield is calculated following a Commission-prescribed formula designed to estimate the yield an investor holding a unit for the expected life of the trust may receive.[53]

2. Advertisements and Sales Literature

The Commission is proposing to amend rule 482 under the 1933 Act and rule 34b–1 under the 1940 Act to require Fixed Income UITs to include a quotation of Estimated Yield, as prescribed by Form S–6, in their advertisements and sales literature that contain a quotation of yield, or other similar quotation purporting to demonstrate the income earned or distributions made or to be made by a Fixed Income UIT.[54] Advertisements and sales literature of Fixed Income UITs that contain a quotation of yield also would be required to contain a legend disclosing that the Estimated Yield quoted is an estimate of the rate of return an investor holding a unit for the expected life of the trust may receive, actual return to the investor may vary from the estimate, and that an investor's units, when redeemed, may be worth more or less than their original cost.[55] As discussed above, Fixed Income UITs that invest substantially all or a portion of their assets in preferred stock, asset-backed securities, or in adjustable-rate securities would be required to provide additional disclosure in their advertisements and sales literature.[56]

Under the proposed amendments, UITs may continue to advertise performance information other than Estimated Yield or Current Yield, including ECR, if a quotation of Estimated Yield is included at least as prominently as the other performance information. The Commission requests comment whether the performance information permitted in all Fixed Income UIT advertisements should be limited to the yields calculated pursuant to the proposed Estimated Yield Formula.

3. Secondary Market Sales

As discussed above, sponsors generally maintain a secondary market in units of the UITs they sponsored. Sponsors typically repurchase units at the redemption price or net asset value of the trust based on the bid side evaluation of the bonds and resell the units to new investors based on the offer side evaluation of the bonds. The proposed Estimated Yield Formula would require that UITs calculate Estimated Yield based on the maximum offering price per unit, which, in the case of a trust the units of which are trading in a secondary market, would be the price at which the sponsor is willing to resell the units.[57]

In some cases, an investor who purchases a UIT in the secondary market will be charged a sales load. The proposed Estimated Yield Formula would require UITs to include in the public offering price of the units the maximum sales load that may be charged to an investor in the secondary market.[58]

C. Alternative Formula

The Commission requests comment whether, in lieu of the Estimated Yield Formula, the Commission should require a trust to calculate and disclose a yield measured by the trust's internal rate of return (''IRR''). IRR is the discount rate that would make the amount paid by the investor for the investment (including sales load) equivalent in value to the payments expected from the trust.[59] Unlike the Estimated Yield Formula, IRR would take into consideration different cash flows unitholders selecting different distribution options will receive. The Commission's staff has discussed with the ICI the desirability and feasibility of a UIT yield formula based on a trust's IRR.[60] In correspondence with the staff in 1990, the ICI asserted that the amount of computer time required to generate IRR for each distribution option for each trust would be so great as to significantly disrupt UIT sponsors' computer operations and increase UIT expenses.[61] In light of the significant advancements in computer technology over the past several years, the Commission requests comment whether calculation of IRR would be feasible, and, if so, whether IRR could provide an accurate but simpler method for calculating UIT yield than the Estimated Yield Formula.

yield. *See* Item 22(b) of Form N–1A under the 1940 Act [17 CFR 274.11A].

[52] A UIT that includes a quotation of tax equivalent yield in its prospectuses, advertisements and sales literature would be required to provide a quotation of its Estimated Yield at least as prominently as its tax equivalent yield.

[53] Paragraph (f)(3) of the proposed Estimated Yield Formula.

[54] Proposed rule 482(f) under the 1933 Act [17 CFR 230.482(f)]; proposed rule 34b–1(c)(2) under the 1940 Act [17 CFR 270.34b–1(c)(2)].

[55] Proposed rule 482(a)(8) under the 1933 Act [17 CFR 230.482(a)(8)]; proposed rule 34b–1(c)(1) under the 1940 Act [17 CFR 270.34b–1(c)(1)].

[56] Instructions 15–16 to the proposed Estimated Yield Formula.

[57] Instruction 11 to the proposed Estimated Yield Formula.

[58] *Id.*

[59] *See* F. Fabozzi, *supra* note 42 at 71–72.

[60] Letter from Kathryn B. McGrath, Director, Division of Investment Management, to David Silver, President, Investment Company Institute (Apr. 17, 1990). A copy of this letter is contained in File No. S7–32–95.

[61] Letter from Craig S. Tyle, Associate General Counsel, Investment Company Institute, *supra* note 27.

III. General Request for Comments

Any interested persons wishing to submit written comments on the rule and form changes that are the subject of this release, to suggest additional changes, or to submit comments on other matters that might have an effect on the proposals contained in this release, are requested to do so.

IV. Cost/Benefit Analysis

The rule and form changes proposed today are intended to improve information regarding the estimated yield of UITs provided to investors by requiring that yield be uniformly calculated in a manner reasonably likely to provide a ''best estimate'' of the return in an investment in a UIT. The Commission believes that any resulting increase in the expenses of UITs and their sponsors will be small, particularly in relation to the benefit of preventing the advertisement of misleading or inaccurate information.

The proposed formula is not expected to be significantly more costly to calculate than current formulas used in connection with UIT offerings. The proposed amendments therefore should result in little increase in the cost of calculating or advertising performance information. Converting to the use of a new formula (*e.g.*, reprogramming computers) would involve certain costs, but the costs of any conversion should be outweighed by the benefits of more accurate UIT yield figures.

V. Summary of Initial Regulatory Flexibility Act Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603 regarding the proposed amendments. The analysis reiterates the reasons and objectives for the proposed amendments discussed above in this Release. The analysis also describes the legal basis for the proposal and discusses its effect on small entities as defined by the 1940 Act. In addition, the analysis considers several alternatives to the proposed amendments such as requiring a trust to calculate its IRR. The analysis notes, however, that these alternatives would not be less costly than the proposed Estimated Yield Formula. The analysis also notes that the proposed Estimated Yield Formula is based on a proposal submitted by the UIT industry. Other aggregate cost-benefit information reflected in the ''Cost/Benefit Analysis'' section of this release also is reflected in the analysis. A copy of the analysis may be obtained by contacting Anthony R. Bosch, Office of Disclosure and Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

VI. Paperwork Reduction Act

Certain provisions of the proposed rule and form amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 [44 U.S.C. 3501 *et seq.*], and the Commission has submitted the rule and form amendments to the Office of Management and Budget for review in accordance with 44 U.S.C. 3507(d). The title for the collection of information is ''Amendments to Regulation C, Rule 34b–1, and Form S–6.'' The Supporting Statement to the Paperwork Reduction Act submission notes that the proposed amendments would amend Form S–6, rule 482, and rule 34b–1 to require certain UITs to use a uniform formula to calculate yields quoted in their prospectuses, advertisements, and sales literature and that the proposed amendments are designed to enhance the ability of prospective investors to make informed investment decisions.

Proposed amendments to Form S–6, Regulation C, and rule 34b–1 would have a negligible effect on the annual reporting and cost burden of UITs. Because most UITs currently calculate yield quoted in their prospectuses, advertisements, and sales literature, the proposed amendments should not significantly increase the reporting and cost burdens in connection with UIT offerings. Form S–6 is used for registration of securities under the 1933 Act by UITs registered under the 1940 Act. UITs file approximately 3263 registration statements on Form S–6 annually. Form S–6 requires an estimated 35 reporting burden hours resulting from the required collection of information. Rule 34b–1 under the 1940 Act governs sales material that accompany or follow the delivery of a statutory prospectus. Approximately 287 respondents (including UITs) each file approximately five responses annually pursuant to rule 34b–1. The recordkeeping burden from rule 34b–1 requires approximately 2.4 hours per response resulting from the required collection of information. Regulation C provides standard instructions to guide registrants filing registration statements under the 1933 Act. Regulation C is assigned one burden hour for administrative convenience because the rule simply prescribes the disclosure that must appear in other filings under the 1933 Act.

The Commission requests specific comment concerning: whether the proposed collection of information is necessary for the proper performance of the function of the Commission, including whether the information shall have practical utility; on the accuracy of the Commission's estimate of the burden of the proposed collection of information; on the quality, utility, and clarity of the information to be collected; and whether the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology may be minimized.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, D.C. 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, Washington, D.C. 20549 with reference to File No. S7–32–95. The Office of Management and Budget is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to the Office of Management and Budget is best assured of having its full affect if the Office of Management and Budget receives it within 30 days of publication.

VII. Text of Proposed Rule and Form Amendments

List of Subjects

17 CFR Parts 230 and 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78d, 78*l*, 78m, 78n, 78o, 78w, 78*ll*(d), 78t, 80a–8, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

2. By amending § 230.482 by removing the comma at the end of paragraphs (a)(1), (a)(2), (a)(3), and (a)(4) and in its place adding a semicolon; by

removing the ‘‘, and’’ at the end of paragraph (a)(5) and in its place adding a semicolon; by removing the period at the end of paragraph (a)(7) and in its place adding ‘‘; and’’; by adding paragraph (a)(8) before the note; by redesignating paragraph (f) as paragraph (g); and by adding paragraph (f) to read as follows:

§ 230.482 Advertising by an investment company as satisfying requirements of section 10.

(a) * * *

(8) In the case of an advertisement of a Fixed Income UIT, defined in Instruction 1 to Form S–6 under the Act, (§ 239.16 of this chapter), containing a quotation of Estimated Yield, defined in Form S–6, or other similar quotation purporting to demonstrate the income earned or distributions made or to be made by the trust, shall also include a legend disclosing that the Estimated Yield quoted is an estimate of the rate of return an investor holding a unit for the expected life of the trust may receive, actual return to the investor may vary from the estimate, and that an investor's units, when redeemed, may be worth more or less than their original cost.

* * * * *

(f) In the case of a Fixed Income UIT, any advertisement containing a quotation of yield, or other similar quotation purporting to demonstrate the income earned or distributions made or to be made by the trust, shall also include a quotation of Estimated Yield that:

(1) Is based on the method of computation prescribed in Form S–6; and

(2) Identifies the date in which an investment in the trust would result in the advertised Estimated Yield.

* * * * *

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

3. The authority citation for Part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a-8, 80a-29, 80a-30 and 80a-37, unless otherwise noted.

* * * * *

4. By amending Form S–6 (referenced in § 239.16) by adding paragraph (f) to Instruction 1 of the Instructions As To The Prospectus to read as follows:

Note: The text of Form S–6 does not and the amendments will not appear in the Code of Federal Regulations.

Form S–6

* * * * *

Instructions as to the Prospectus

Instruction 1. Information to be Contained in Prospectus.

* * * * *

(f) Information Concerning Registrant's Performance.

Estimated Yield. In the case of a trust that invests substantially all of its assets in bonds and other debt instruments, preferred stock, or a combination of these types of securities (‘‘Fixed Income UIT’’):

(1) Furnish the trust's estimated yield to maturity (‘‘Estimated Yield’’) calculated as of a day reasonably close to the effective date of the registration statement or the commencement of the offering:

Estimated Yield = [(a-b) * c] - x

Where,

a = sum of (market value of each security * yield to maturity of each security * time to maturity of each security)/sum of (market value of each security * time to maturity of each security)

b = total annual expenses of the trust/net asset value of the trust

c = 1 - sales load

$$x = \text{sales load} * \frac{r}{(1+r)^n - 1}$$

r = (a-b) * c

n = number of annual periods until amortization date.

(2) Provide a statement that the trust's Estimated Yield is calculated following a SEC-prescribed formula designed to estimate the yield an investor holding a unit for the expected life of the trust may receive, but that actual investor experience may be different.

(3) If the trust provides an estimated rate of return calculated using a different method, provide a brief description of the relevant differences between the other rate of return and the trust's Estimated Yield.

Instructions

Yield to Maturity

1. In determining the yield to maturity and time to maturity of each security in ‘‘a’’, consider the maturity of a security with a call provision(s) as the date with the lowest resulting yield to call, yield to par option, or yield to maturity pursuant to rule G–15 of the Municipal Securities Rulemaking Board.

2. In determining the yield to maturity of each security in ‘‘a’’, subtract from the amount of each security's first coupon payment and add to the amount of each security's last coupon payment the amount of accrued interest of that security as of the date of deposit. (This accrued interest also should be included in the price of each bond.) In calculating Estimated Yield subsequent to the initial offering of the trust, use the same amount of accrued interest. In the case of a trust in which all accrued interest at the date of deposit is paid by the sponsor or a person other than a unitholder, this Instruction does not apply.

3. In determining the market value of each security and the net asset value of the trust in ‘‘a’’ and ‘‘b’’ respectively, include the amount of accrued interest or any advance of accrued interest that is paid by unit holders upon purchase of the units.

4. In determining the net asset value of the trust in ‘‘b’’, do not include the amount of repayments of principal of securities held in a trust's portfolio that are to be distributed to unitholders.

5. In the case of a tax exempt obligation issued without original issue discount and having a current market discount, use the coupon rate of interest in lieu of the yield to maturity. Where, in the case of a tax exempt obligation with original issue discount, and the discount based on the current market value exceeds the then-remaining portion of original issue discount (market discount), the yield to maturity is the imputed rate based on the original issue discount calculation. Where, in the case of a tax exempt obligation with original issue discount, and the discount based on the current market value is less than the then-remaining portion of original issue discount (market premium), the yield to maturity should be based on the market value.

6. In the case of a trust that invests in units of other trusts for which an Estimated Yield is not available from the sponsor, determine the yield to maturity of the other trust using the other trust's average dollar price, average coupon rate, and average yield to maturity. Determine the other trust's average dollar price by dividing the sum of the net asset values of the bonds in the other trust by the sum of the par values of the bonds. Determine the other trust's average coupon rate and average yield to maturity by weighting the coupon rate and yield to maturity of each bond in the other trust by its market value.

Sales Load

7. Sales load in ‘‘c’’ and ‘‘x’’ is the maximum sales load stated as a percentage of the offering price of units. In the case of a deferred sales load, the maximum sales load is the aggregate of all installment loads, stated as a percentage of the offering price.

8. In determining the amortization date of a trust in ‘‘n’’, calculate an average, weighted by market value, of the expected lives of the bonds in the trust. To calculate the expected life of each bond in the trust:

(a) For bonds priced at par or at a discount and for bonds priced at a premium where the yield to maturity is less than or equal to yield to call (as determined by Instruction 1) plus .4% (40 basis points), use the maturity date of the bond(s); and

(b) For bonds priced at a premium where yield to maturity is greater than yield to call (as determined by Instruction 1) plus .4% (40 basis points), use the call date of the bond(s).

Expenses

9. A trust that has different Estimated Yields for different classes of unit holders, (*e.g.*, because of different distribution payment options that result in different expense ratios) may include a quotation of more than one Estimated Yield. If such a trust quotes a single yield, in determining the total annual expenses of the trust in ‘‘b’’, assume the highest expense ratio is applicable to all of the assets of the trust.

Tax Equivalent Yield

10. If a trust quotes a tax equivalent yield, calculate tax equivalent yield by dividing that portion of the yield of the trust that is tax exempt by one minus a stated income tax rate and adding to the product that portion, if any, of the yield of the trust that is not tax exempt. Any quotation of tax equivalent yield in the trust's prospectus, advertisements, or sales literature, should be accompanied by a quotation of Estimated Yield that is given equal prominence.

Secondary Market Sales

11. In calculating Estimated Yield subsequent to the initial offering of the trust, use the maximum public offering price at which the trust's sponsor is willing to sell trust units to an investor and the maximum sales load that may be charged to an investor for trust units.

Preferred Stock, Asset-Backed Securities, and Adjustable-Rate Securities

12. In the case of preferred stock:

(a) In lieu of yield to maturity in ''a'', use the preferred stock's interest rate calculated by dividing the security's dividend by its market value and by annualizing on a straight-line method, (*e.g.*, multiply a quarterly payment rate by 4);

(b) In determining the amortization date in ''n'', in the case of preferred stock that can be converted to common stock or is subject to a redemption feature, use as the security's expected life: the lesser of the time period to its conversion date, its redemption date or the trust's termination date; and

(c) In determining the amortization date in ''n'', in the case of all other preferred stock, use the trust's termination date as the security's expected life.

13. In determining each asset-backed security's yield to maturity in ''a'' and in determining each asset-backed security's amortization period in ''n'', in lieu of its maturity date, use the same ''expected life'' of the security used for calculating the price of the security as part of the trust's net asset value.

14. (a) For adjustable-rate securities not subject to a demand feature, use the next reset date as the maturity date for calculating yield to maturity in ''a''; and

(b) For adjustable-rate securities subject to a demand feature, use the time remaining until the next demand date or the next reset date, whichever is less, as the maturity date for calculating yield to maturity in ''a''.

15. In the case of a trust that invests some of its assets in preferred stock, asset-backed securities, or adjustable-rate securities, in addition to the disclosure required by paragraph (f)(2) of Form S–6, disclose that some of the trust's assets (____%) is invested in (preferred stock, asset-backed securities, or adjustable-rate securities), and, because the continued payment of interest or other income (and return of principal for asset-backed securities) for these types of securities cannot be predicted, this portion of the trust's yield *will* vary and, as a result, actual investor experience *will* be different.

16. In the case of a trust that invests substantially all of its assets in preferred stock, asset-backed securities, or adjustable-rate securities refer to its yield, calculated pursuant to the Estimated Yield Formula, as ''Current Yield''; and, in addition to the disclosure required by paragraph (f)(2) of Form S–6, disclose that, because the continued payment of interest or other income (and return of principal for asset-backed securities) for these types of securities cannot be predicted, the trust's yield *will* vary and, as a result, actual investor experience *will* be different. Provide a cross-reference to the part of the prospectus in which the portfolio securities are described.

17. In the case of a trust that invests substantially all or a portion of its assets in preferred stock, asset-backed securities, or adjustable-rate securities and provides a yield in its advertisements pursuant to Rule 482 under the Act [17 CFR 230.482], or in its sales literature in compliance with Rule 34b–1 under the 1940 Act [17 CFR 270.34b–1], in lieu of the disclosure required by Rule 482(a)(8) under the Act [17 CFR 230.482(a)(8)] or Rule 34b–1(c)(1) under the 1940 Act [17 CFR 270.34b–1(c)(1)] provide the disclosure required by Instructions 15 and 16 (excluding the cross-reference) as appropriate.

Securities Denominated in Foreign Currencies

18. In the case of a security denominated in a foreign currency, convert its market value into U.S. dollars at the exchange rate in effect at the time of calculation.

Additional

19. Determine Estimated Yield to the nearest hundredth of one percent. Use calculations using market price, accrued interest, annual periods, expenses, net asset value, or number of years to the nearest one thousandth. Base calculations using yield to maturity, coupon rate, or sales load to the nearest thousandth of one percent.

20. In the case of a post-effective amendment to the trust's registration statement, calculate the trust's Estimated Yield as of a date reasonably close to the date of filing of the post-effective amendment.

* * * * *

PART 270—GENERAL RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

5. The authority citation for Part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–37, 80a–39 unless otherwise noted;

* * * * *

6. By revising § 270.34b–1 to read as follows:

§ 270.34b–1 Sales literature deemed to be misleading.

Any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act [15 U.S.C. 80a–24(b)] (''sales literature'') shall have omitted to state a fact necessary in order to make the statements made therein not materially misleading unless the sales literature includes the information specified in paragraphs (a), (b) and (c) of this section.

(a) Sales literature for a money market fund shall contain the information required by paragraph (a)(7) of § 230.482 of this chapter.

(b) Except as provided in paragraph (d) of this section, any sales literature containing performance data of an open-end management investment company or a separate account registered under the Act as a unit investment trust offering variable annuity contracts shall also include:

(1) The disclosure required by paragraph (a)(6) of § 230.482 of this chapter; and

(2) The following additional performance data, which shall meet the currentness requirements of paragraph (g) of § 230.482 of this chapter:

(i) Except in the case of a money market fund, the total return information required by paragraph (e)(3) of § 230.482 of this chapter;

(ii) In the case of sales literature containing a quotation of yield or other similar quotation purporting to demonstrate the income earned or distributions made by the company, a quotation of current yield specified by paragraph (e)(1) of § 230.482 of this chapter, or, in the case of a money market fund, paragraph (d)(1) of § 230.482 of this chapter; and

(iii) In the case of sales literature containing a quotation of tax equivalent yield or other similar quotation purporting to demonstrate the tax equivalent of income earned or distributions made by the company, a quotation of tax equivalent yield specified by paragraph (e)(2) and current yield specified by paragraph (e)(1) of § 230.482 of this chapter, or, in the case of a money market fund, paragraph (d)(1) of § 230.482 of this chapter.

(c) Any sales literature containing a quotation of yield, or other similar quotation purporting to demonstrate the income earned or distributions made or to be made by a Fixed Income UIT defined in Instruction 1 to Form S–6 under the Securities Act of 1933, (§ 239.16 of this chapter), shall also include:

(1) The disclosure required by paragraph (a)(8) of § 230.482 of this chapter; and

(2) A quotation of Estimated Yield specified by paragraph (f) of § 230.482 of this chapter which shall meet the currentness requirements of paragraph (g) of § 230.482 of this chapter.

(d) The requirements specified in paragraph (b) of this section shall not apply to any quarterly, semi-annual or annual report to shareholders under section 30 of the Act [15 U.S.C. 80a–29], containing performance data for a period commencing no earlier than the first day of the period covered by the report; nor shall the requirements of paragraphs (e)(3)(ii) and (g) of § 230.482 (e)(3)(ii) and (g) apply to any such periodic report containing any other performance data.

Note to § 270.34b–1: Sales literature of an open-end management company or a separate account (except that of a money market fund) containing a quotation of yield or tax equivalent yield must also contain the total return information. In the case of sales literature, the currentness provisions apply from the date of distribution and not the date of submission for publication.

Dated: November 22, 1995.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95–29109 Filed 11–28–95; 8:45 am]

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